

## MICRO-FINANCE: A STUDY ON BRIC COUNTRIES

PRANJAL KUMAR CHAKRAVARTI

Assistant Professor, Department of Commerce, Scottish Church College Kolkata, West Bengal India

### ABSTRACT

Microfinance is “the provision of a broad range of financial services such as deposits, loans, money transfers, and insurance to small enterprise and households”-ADB. The concept of microfinance originated in the nineteenth century and was conceptualised by Lysander Spooner who wrote for the first time the benefits of small credits to entrepreneurs and farmers as a way of alleviating poverty. Nowadays, microfinance is considered to be an important mechanism to generate income and employment opportunities to a large section of underprivileged populace and plays a key role in poverty alleviation in developing nations.

The growing political and economic significance of emerging economies such as Brazil, Russia, India and China (BRIC countries) provide a general context for the future of microfinance. Present study focuses on the evaluation of microfinance in emerging economies of BRIC countries.

**KEYWORDS:** BRIC Countries, Financial Services, Microfinance

### INTRODUCTION

The term ‘micro’ literally means small and hence micro finance simply means the provision of small loans to target groups aimed at alleviating poverty and promoting entrepreneurial ability amongst the beneficiaries for inclusive growth of an economy. Microfinance aims at providing poverty-stricken people to have permanent access to a wide range of financial services, including not just credit but also savings, insurance and fund transfers. It helps the poor people get access to funds at low interest rates over a period of time, creates trust and social capital and promotes entrepreneurial ability amongst them. It also leads to stability and growth in their communities.

The concept of microfinance originated in the nineteenth century and was conceptualised by the theorist Lysander Spooner who wrote for the first time the benefits of small credits to entrepreneurs and farmers as a way of alleviating poverty. Based on this concept, Friedrich Wilhelm Raiffeisen founded the first cooperative lending banks to support farmers in rural Germany. However, the modern concept of ‘Microfinance’ traces its origin to 1970s when organisations such as Grameen Bank of Bangladesh, under the leadership of microfinance pioneer Muhammad Yunus started and shaped the modern industry of micro-financing. Nowadays, microfinance is considered to be an important mechanism to generate income and employment opportunities to a large section of underprivileged populace and plays a key role in poverty alleviation in developing nations.

### LITERATURE REVIEW

Early researchers in the field of microfinance like **Liew** (1998), **Bansal** (2003) and **Weiss** (2005) found out that microfinance can be a very useful tool to reduce the poverty and provide the people with an opportunity to earn higher income. **Chemim** (2008) points out the main components of microfinance: deposits, loans, payment services, money

transfers and insurance to poor and low-income households and their microenterprises. Thus, microcredit is only a component of broad spectrum of micro-financing. **Vijayakumar A** (2009) studied the multi-agency approach adopted by India for the development of its micro-finance programme and focussed mainly on the microfinance initiative of NABARD relating to SHG-Bank linkage programme.

## OBJECTIVES OF THE STUDY

In this context, the study revolves around the following objectives:

- To examine the role of microfinance in developing nations.
- To study the evolution and growth of microfinance in emerging economies namely
- Brazil, Russia, India and China.
- To identify the opportunities and challenges associated with the growth of
- Microfinance in BRIC countries.

## METHODOLOGY

The study is descriptive in nature and is entirely based on secondary data. For this purpose, previous research works, reports, articles and journals on microfinance have been referred to and information have also been collected from websites of World Bank, IMF and microfinance organisations of Brazil, Russia, India and China.

## EVOLUTION AND GROWTH OF MICROFINANCE IN BRIC COUNTRIES

### BRIC COUNTRIES: AN OVERVIEW

BRIC is an acronym coined to refer to the group of four major emerging economies of the world comprising **Brazil, Russia, India and China**. The four countries represent widely differing political systems: China is a one-party state; Russia's government is highly centralised; Brazil and India are democracies with significant corruption and/or ethnic strife still to be dealt with. They have differing demographic trends. Brazil has a predominantly urban population, while India is still largely rural. Russia has an ageing population, while India is relatively young. They have also reached varying levels of economic development with China outpacing other member nations of the group in economic size, growth and trade.

The following table shows the growth rate of Gross Domestic Product of BRIC countries:

**Table 1: Growth Rate of Gross Domestic Product (Percent)**

Year Country	2005	2006	2007	2008	2009	2010	2011	2012
Brazil	3.2	4.0	6.1	5.2	-0.6	7.5	2.7	3.0
Russia	6.4	8.2	8.5	5.2	-7.8	4.3	4.3	4.0
India	9.2	9.8	9.4	7.3	5.7	10.6	7.2	6.9
China	10.4	11.6	13.0	9.6	8.7	10.4	9.2	8.2
World	4.5	5.1	5.2	3.0	0.6	4.2	2.8	2.7

[Source: World Economic Outlook, IMF (2012)]

In 2005-2010, BRIC countries contributed about 28% of global economic growth. Their sheer size is

overwhelming: about 40% of the world's people live in the BRIC countries, including more than 37% in India and China alone. They are already among the largest 10 economies measured by purchasing power parity, and they hold about 30 % of the world's foreign exchange reserves.

### **EVOLUTION & GROWTH OF MICROFINANCE IN BRAZIL**

Microfinance in Brazil originated in 1972 when the first microenterprise credit program in was started in Recife, Brasil. Since then, the Government of Brazil has undertaken a number of initiatives to stimulate the sector over the past two decades. In Brazil, there are roughly four types of institutions offering microfinance services. They are -

- State-owned development bank
- Public Interest Civil Society (OSCIPs)
- Microenterprise Credit Society (SCMs)
- Commercial banks

In 1997, the state-owned development Bank Banco do Nordeste opened its Crediamigo program. In its first full year (1998) Crediamigo took on as many clients as all other MFIs combined by the Crediamigo Microfinance in Brazil is dominated program which currently reaches around 150,000 clients and features a total portfolio of just under US\$ 60 million. At around US\$ 250, it has one of the lowest average loan balances in the region, roughly 6 percent of GNP per capita.

Brazil appears to possess the perfect conditions for microfinance to thrive. It has the highest concentration of income in South America and the country has a well-developed financial market in terms of retail banking. On the contrary, about 33% of the total population live on less than US 1 dollar per day. Despite the tremendous potential of microfinance, the microfinance sector in Brazil has failed to reach a relevant level of growth and only about 2 to 3 percent of the total potential market for microfinance products has been tapped successfully.

The microfinance sector in Brazil is dominated by the presence of a large number of micro enterprises and wide accessibility of multiple credit options to these enterprises. At present, there are 16.4 million micro enterprises in Brazil out of which 8.2 million are potential customers for microfinance products. However, currently only 1.1 million micro enterprises are current clients of microfinance products. Hence, there is a huge untapped potential for microfinance in Brazil that needs to be tapped with efficient delivery mechanism and innovative microfinance products.

### **EVOLUTION & GROWTH OF MICROFINANCE IN RUSSIA**

Among the BRIC countries, Russia is the second most important country so far as the booming demand for microfinance is concerned. USAID supported the development of microfinance in Russia by bringing the first microfinance models to the country in 1994 and then in working with Russian partners to adapt those models to Russian conditions. In 1990s, Microfinance Institutions (MFIs) had a hard time getting a footprint because the needs were vast and every time there was a banking crisis, commercial banks withdrew funds from the client base. Since that time, many microfinance institutions have developed, and many legal and regulatory improvements have been achieved through the joint efforts of microfinance practitioners, government organizations, legislators, and donor organizations. In 2008-09, the microfinance industry in Russia was once again hit hard with global recession as a result portfolios had been halved and

banks got serious losses.

In 2009, important developments occurred in the regulation of credit cooperatives. On 4 August 2009, the Federal Law on Credit Cooperatives, pending before the State Duma since March 2001, finally entered into force. According to the provisions of the Federal Law, credit cooperatives must their charters within one year to conform to the new standards and bring their financial performance to a required level. With the adoption of this law, all credit cooperatives in Russia (except agricultural) are subject to a single policy framework, and now have an opportunity to build a self-regulated system. The enactment of this law has allowed the Microfinance Institutions (MFIs) and banks to provide lending to small entrepreneurs so as to alleviate the financial burden on small business in Russia and has also given the much needed impetus for growth of the microfinance industry in Russia.

## **EVOLUTION & GROWTH OF MICROFINANCE IN INDIA**

Microfinance in India can trace its origins back to the early 1970s when the Self Employed Women's Association (SEWA) of the state of Gujarat formed an urban cooperative bank, called the Shri Mahila SEWA Sahakari Bank, with the objective of providing banking services to poor women employed in the unorganised sector in Ahmedabad City, Gujarat. The microfinance sector went on to evolve in the 1980s around the concept of SHGs, informal bodies that would provide their clients with much-needed savings and credit services. From humble beginnings, the sector has grown significantly over the years to become a multi-billion dollar industry, with bodies such as the Small Industries Development Bank of India and the National Bank for Agriculture and Rural Development devoting significant financial resources to microfinance. During the financial year 2007-08, microfinance had served over 33 million Indians out of which around 80% clients were women. During the same year, outstanding microcredit portfolio of India Microfinance was about Rs. 22,000 crore, out of which 75% are accounted for by SHG- Bank Linkage Program, 20% by large MFIs and 5% by medium and small MFIs. India's MFIs operated in 209 out of 331 poorest districts of the country. Today, the top five private sector MFIs reach more than 20 million clients in nearly every state in India and many Indian MFIs have been recognized as global leaders in the industry.

Microfinance in India is currently being provided by three sectors: the government, the private sector and charities. These three sectors, as large as they are, have only a small fraction of the capital and geographic scale required to meet the overwhelming need for finance amongst India's rural poor. According to recent RBI estimates, there are over 450 million "unbanked people" in India, most of who live in rural areas. The term "unbanked" refers to people who have no access to formal financial services, but rather must rely on either family, or informal providers of finance, such as the village moneylender. Despite such huge demand for microfinance, the top 10 private sector microfinance providers in India together could serve only about 5% of the unbanked population of India.

In this context, private sector MFIs have an essential role to play for the growth of microfinance in India as neither the government nor charities have the capital nor business model required to meet the insatiable demand for finance in rural India.

## **EVOLUTION & GROWTH OF MICROFINANCE IN CHINA**

Microfinance in China owes its origin to 1993 when the microfinance operations of MFI-NGO were established by CASS. However, microfinance operations started to expand only from 1998 when the Government of China adopted

microcredit as an instrument for poverty alleviation and transformed subsidized lending schemes into microfinance programmes. Since then, a range of initiatives have been launched from different governmental and non-governmental sources in the past years to improve the state of microfinance industry in both urban and rural areas of China. A large number of microfinance projects were undertaken by non-governmental organizations (NGOs) since 1990s and taking a cue from this the People's Bank of China (PBOC) and the China Banking Regulatory Commission (CBRC) started microfinance pilot projects in 2005 and 2006, respectively. These initiatives led to the establishment of new types of institutions providing microfinance, most importantly Microcredit Companies (MCCs) and Village and Township Banks (VTBs). In addition, at the end of 2006, the China Postal Savings Bank (CPSB) received a license to enter the rural credit market. These new microfinance providers complement traditional banking institutions like Rural Credit Cooperatives (RCCs) and the Agricultural Bank of China (ABC), which began to experiment with microcredit offerings in the late 1990s. In 2008, CBRC and PBOC allowed social capital to fund and set up credit only Micro-credit companies (MCCs) and also allowed natural persons, corporate legal entities and social organizations to invest in microfinance. Although microfinance has significantly developed during recent years in China, there still remain major differences to international standards. Chinese Microfinance Institutions (MFIs) currently provide small loans as their only microfinance product, excluding savings, insurance or transfer payments from their product portfolio. The loan sizes provided by Chinese MFIs are also of very high size in comparison to global standards. The overall outreach of new microfinance providers is still modest, the capability of most MFIs to deploy good micro lending methodology is limited, traditional financial institutions have experienced very low repayment rates on their microfinance initiatives, and some of the most interesting reforms have begun as pilot programs only a few years ago. As such, the microfinance industry in China is still in its early growth phase and there is enormous opportunity for microfinance in China.

## OPPORTUNITIES AND CHALLENGES OF MICROFINANCE IN BRIC COUNTRIES

Microfinance is at different stages of growth and development in each of the BRIC countries. Among all the BRIC countries, microfinance is growing at a very rapid pace in **India** and **Russia**. China and Brazil have also recently realized the importance of microfinance as a tool of poverty alleviation and entrepreneurship development among poor people and as such have taken giant strides in promoting microfinance to tap the so far huge untapped market. A comparative study on the relative opportunities and challenges associated with the growth of microfinance in all the BRIC countries is as under

**Table 2: Relative Opportunities of Microfinance in BRIC Countries**

Sl No.	Basis	Brazil	Russia	India	China
1	Number of Participants	A large number of micro-enterprises eligible to operate in microfinance sector.	Ability to manage the saving and loan products of Micro Finance Institutions.	Presence of a large number of micro-enterprises in microfinance sector.	Presence of a large number of micro-enterprises in microfinance sector.
2	Access to Multiple Credit Options	Wide accessibility of multiple credit options to micro-entrepreneurs.	Lower cost of finance related to members' savings and external debt.	Wide accessibility of multiple credit options to micro-entrepreneurs.	Wide accessibility of multiple credit options to micro-entrepreneurs.
3	Economic Scenario	Advanced banking sector and well developed	Ability to establish reasonable pricing policies.	Availability of small and medium sized MFIs in rural	Strong economy and well developed banking sector

		financial market ensuring cost efficiency.		areas.	promoting growth of microfinance.
4	Market Concentration	Highest income concentration in South America with unique demand profile.	High demand of micro loans by the growing medium and small scale business sector.	Huge untapped market that needs to be addressed by microfinance sector.	Huge untapped market that needs to be addressed by microfinance sector
5	Characteristics of MFIs	Presences of highly experienced micro-entrepreneurs ensure innovative financial products tailor-made for target groups.	Well developed capital market promoting growth of microfinance.	Huge employment opportunities through forming self-help groups and micro enterprises.	Presence of a large number of micro-enterprises in every nook and corner of the nation.
6	Capability Building	Overall microfinance penetration still very low in spite of huge demand.	Efficiency of MFIs in generating revenue and managing costs.	Government policy of total financial inclusion promoting microfinance.	Overall microfinance penetration still very low in spite of huge demand.
7	Influential Factors	Regulatory environment continues to affect the microfinance sector.	Volatility in capital market affects the performance of MFIs.	Lack of proper regulatory mechanism affects the microfinance sector.	High cost of operations and government intervention affect the microfinance sector.
8	Barrier	High interest rates act as major hindrance to the growth of microfinance.	High transaction costs and higher operating costs hinder the growth of microfinance.	High rate of credit risk and defaults are a major cause of concern for the MFIs.	Marked income gap between inland/coastal areas, and rural/urban areas.
9	Demonstration	Lack of a demonstration effect hinders the industry.	Lack of a demonstration effect hinders the industry.	High number of people access informal sources for their borrowing.	Struggle with poverty and inequity between regions.
10	Socio-economic Influence	Crowding out by public sector credit lines affects demand for and attitudes towards credit in rural areas.	Volatility in the microfinance industry due to economic forces and international factors.	Political interference hinders effective implementation of microfinance schemes.	Excessive regulations hinder effective implementation of microfinance schemes.
11	Growth Barrier	Hyperinflation increases the cost of operations thereby hindering the growth of microfinance.	High cost of operations restricting the growth of microfinance industry.	High cut-throat competition between MFIs and high transaction cost hinder the growth of microfinance.	High regional disparity hampering the growth of microfinance industry.

## CONCLUSIONS AND RECOMMENDATIONS

It is evident from the above study that there have been definite growth of microfinance in all the BRIC countries in recent years. Microfinance is now considered as an important mechanism for poverty alleviation and entrepreneurship development amongst the underprivileged classes of the society in an economy and has developed deep roots in emerging

economies like Brazil, Russia, India and China.

Following are some recommendations for the improvement of existing scenario of microfinance sector in BRIC countries:

- Focus on lower-income micro-entrepreneurs.
- More pro-active role of Government that would not only create a favourable environment for microfinance but also directly deliver financial services to the needy segments of the society.
- Increase use of wireless technology to open up access to finance and reduce transaction costs at the same time.
- Develop tailor-made products that would properly address client needs.
- Promote understanding of products through effective marketing.
- Explore alternative distribution channels that would diversify existing distribution mechanism of micro finance.
- Form a viable long-term strategy for sustainable growth of microfinance and adopt supporting business practices.
- Simplify the existing regulatory framework governing microfinance thereby minimising compliance costs and maximising the ambit of microfinance.

It is to be noted that a number of initiatives have already been taken in the emerging economies and specifically in BRIC countries for the growth of microfinance. Wireless technology is increasingly being used in microfinance to open up access to finance for large numbers of excluded people into the ambit of microfinance. The International Telecommunication Union (ITU) 'Connect the World' initiative proposes to raise coverage to 100 percent by 2015. Such widespread access will change not only information flows but also financial service delivery. Moreover, it is also noteworthy that in the BRIC countries, governments are getting involved in delivering financial services to the poor directly. Apart from this, international actors such as donors, technical assistance providers, and microfinance networks are also playing an important role in the growth of microfinance.

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